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IN THE

Supreme Court of the United States

OCTOBER TERM, 1933

No. 64

AMY ARZT AND JOSEPHINE RAMSEY,
Petitioners,

vs.

RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS, *et al.*, etc.,
Respondents.

BRIEF OF RESPONDENTS REORGANIZATION COMMITTEE IN REPLY TO BRIEF OF PETITIONERS ARZT AND RAMSEY.

LAWRENCE BENNETT,
MAYNARD TEALL,
G. FRANKLIN LUDINGTON,
Counsel for Respondents Reorganization Committee.

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Statute

U. S. Judicial Code, Section 240a 2

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Respondents.

BRIEF OF RESPONDENTS REORGANIZATION COMMITTEE IN REPLY TO BRIEF OF PETITIONERS ARTZ AND RAMSEY.

Opinions of the Courts Below

The opinion of the District Court filed simultaneously with the entry of the final decree of sale is printed at pages 280-283 of the printed Transcript of Record. The opinion of the District Court filed in connection with the decree confirming sale is printed at page 463 of the Record. Neither of these opinions has been published. The opinion of the United States Circuit Court of Appeals for the Third Circuit is reported in 64 Federal Reporter (2d Series) at page 847, *et seq.*, and appears in the printed Transcript of Record at pages 534-544.

Jurisdiction

The jurisdiction of this Court rests on § 240a of the Judicial Code as amended by Act of February 13, 1925, c. 229; § 1, 43 Stat. 938 (28 U. S. C. A., § 347a).

Corrections of Statements in the Petitioners' Brief

There occur in the petitioners' brief some of the errors of statement appearing in the briefs of other petitioners in this cause.* The jurisdiction of the District Court was invoked, it is said (*3*), "solely for the purpose of effectuating a reorganization of the company in order to scale its funded debt and to coerce non-assenting Debentureholders into subjection to the Plan or else to wipe them out" (*3*). This is both a misleading and a too inclusive statement. The purpose of the Reorganization Plan itself was admittedly to adjust to the exigencies of the case the fixed charges which burdened the enterprise. But the Plan was offered for the voluntary acceptance of securityholders and the Committee have at no time had the intent either to coerce non-assenting Debentureholders into subjection to the Plan or to wipe them out. Moreover, the creditors' bill filed by the Committee with the District Court was for the primary purpose, as it expressly stated, of preventing dissipation and waste of the Corporation's property by execution sales, irrespective of whether or not any reorganization were ever consummated, because, as the petitioners' brief elsewhere states (*12*), through the petitioners' counsel actions at law had been instituted and were then threatened "by non-assenting Debentureholders" on their interest coupons. The creditors' bill, in addition to alleging the foregoing, averred also that the defendant Corporation had no means

*References by figures in italics being to pages of the petitioners' brief.

at hand with which to meet the interest charges overdue on its Debentures, without seriously jeopardizing the ability of the defendant to continue in business and without making it difficult or impossible for the defendant to continue the operation of its plants and the sale of its products (R. 11). In substance, this was an averment of the defendant's imminent insolvency and the Record shows that when Receivers were appointed the defendant's cash was but little in excess of its current liabilities totaling $1,035,000 (R. 499), and its overdue sinking fund obligation of $32,068.50. **With the forthcoming maturity on December 31, 1931 of a $20,000 note held by International Heater Company (R. 132) and the forthcoming maturity on February 1, 1932 of another installment of Debenture interest and sinking fund amounting to $554,868, the Corporation faced complete insolvency in every sense of the word.** This suit was brought, therefore, on the ground, among others, of the defendant's imminent insolvency (*3*). When the District Court later entered its confirmatory decree, there was before it the June 30, 1932 balance sheet (R. 523, 524), showing accrued Debenture interest of $1,325,257.90, together with other current liabilities, all aggregating $1,556,793.41. In addition, $24,200 was owing International Heater Company on one past due note (R. 132). These liabilities (*exclusive of sinking fund installments in arrears since August 1, 1931*) amounted to more than the entire cash working capital of the Corporation.

The Corporation's default in the payment of Debenture interest February 1, 1931 was to conserve cash in order that business operations might continue (R. 501). It was not a part of a plan to reorganize (*5*), since at that time no plan of reorganization had been formulated.

The decision of the directors was first and primarily,

that the best interests of everyone, including Debentureholders, would be served if interest payments were discontinued, so that working capital might be conserved. The fact is, and is plainly stated in the Reorganization Plan, that the Corporation omitted payment of interest on its Debentures because its management was firmly convinced that liquidation of the Corporation would prove disastrous to creditors and that its cash must be conserved, if the enterprise were to be continued as a going concern. Of course, the directors' decision to omit payment of Debenture interest as a means of continuing the business entailed the decision that the capital structure should be reorganized, but it is not true, as petitioners suggest, that the interest payment was omitted to bring about reorganization. Reorganization was not an end in itself, it was recommended by the directors only as a means of salvaging the maximum value of the assets for creditors. The Reorganization Committee was "inaugurated" by the Corporation, but it is not accurate to say that it was "acting in behalf of the company" (*6*). The Corporation's management merely asked the members of the Reorganization Committee to serve as such, but they have acted primarily on behalf of the creditors.

The Reorganization Plan decidedly is not "in the interest of the company" (*6*), since it practically wipes out all stockholders and wipes out completely common stockholders, with the exception of a potential interest extended them in the form of option warrants, for which they must pay $1 each and which merely give the right to buy shares of new common stock at $20 per share (R. 40, 41). The Reorganization Plan does not discriminate "against Debentureholders in favor of other creditors of equal rank", merely because the New Company assumes the payment of approximately $40,000 of merchandise claims.

It is not true that the Plan places the value of $100 a share upon the new preferred stock (*8*). The new preferred stock is **without par value** and the amount to which it is entitled on liquidation is merely the measure of its priority over the common stock (R. 39).

It is not true that a valuation of $20 per share is placed upon the new common stock "in the scheme of reorganization". (*8*). This new common stock **will be without par value**, and $20 is nothing but the option price at which it may be purchased at some time in the future (R. 40). Were the value of the new common stock $20 per share, the value of the new securities given to Debentureholders would be $1,400 for every $1,000 of present Debentures. The suggestion of petitioners (*8*) that the capital of the reorganized Corporation will be some $16,000,000 is wholly unwarranted.

As shown above, at the date of receivership (adopting petitioner's own method of crediting to sinking fund $158,000 of treasury Debentures canceled after receivership), the defendant was indebted for accrued interest and sinking fund and other current liabilities to a total of $1,067,068.50. Had this amount been paid, it would have left cash of only $190,313,—not $400,000 (*13*).

The subsequent intervention of Bankers Trust Company, as Trustee, was at the request of holders of more than 90% of the Corporation's Debentures (*14*) (R. 112-114). These Debentureholders were creditors to the extent of more than $9,000,000. It happened that one of these creditors was connected with the Corporation's management, but he was the holder of more than $1,000,000 principal amount of these Debentures (R. 444) and by the terms of the Reorganization Plan under which his Debentures were deposited, his interest as a stockholder of the Corporation was virtually wiped out. With these incontrovertible

facts in mind, it is thus not accurate to say that "those who were responsible for the default in the payment of the interest" were using that default "as the pretext for declaring the Debentures due" (*15*). Those who were responsible for the default were the directors of the Corporation. Those who declared the Debentures due were the holders of over 90% of the Debentures.

In our brief in the companion cases at Nos. 62 and 63, we have had occasion to point out that the testimony offered the District Court as to the value of the defendant's properties was the most expert and responsible that could have been obtained. It could in no way have been characterized as a matter of "notions" (*17*). The properties themselves sold for $2,550,000, approximately 22% of the face amount of the Corporation's outstanding debt. It is submitted that under present-day conditions, with a business which like almost every business today engaged in the building trade is operating without profit, this represents a very substantial price and considerably higher than the percentage of return which stockholders in comparable businesses could receive today through a sale of their shares.

It is not true that merchandise and service creditors are to be paid in full "out of the proceeds" of the sale under the decree entered by the District Court (*20*). **There is absolutely nothing in the decree relating to the payment of merchandise and service creditors.** Under the decree, all creditors will share in the net proceeds of the sale as may hereafter be provided in the order of distribution of the District Court (R. 310), and of course the District Court will direct that all general creditors share *pro rata*. It is the Plan of Reorganization, not the decree of sale, which provides that "the new Company will assume and agree to

pay in full all the liabilities of the Corporation for taxes, wages, services and merchandise * * *" (R. 37).

It is not true that the Circuit Court of Appeals sustained the exercise of jurisdiction by the District Court on the ground of "possible future insolvency" (*21*). The opinion of WOOLLEY, C. J., which is quoted on page 22 of the petitioners' brief, said that payment of interest *"foretold imminent consequences disastrous to the Corporation"* and that *"plainly those consequences were insolvency with its attendant evils to all concerned."*

Summary of Argument

The brief of petitioners is replete with evidences of complete misapprehension as to the nature and effect of the Plan of Reorganization itself; and petitioners' argument is based in large part upon this misapprehension. It therefore seems necessary that our argument be devoted in large part to an analysis of the petitioners' theory of this case and to a refutation of the fallacies upon which it is based. Apparently petitioners entertain the notion that this Plan of Reorganization is of benefit to the Corporation and that the Corporation will be better off after the reorganization than before. Illustrative of petitioners' misconceptions in this regard are the following statements appearing on the below indicated pages of petitioners' brief:

> "Courts of equity are not sanctuaries to which solvent corporations may flee for refuge from their creditors." (*30*)
>
> "The sale was employed as a device to effect a transposition of the assets from the old company to the new, in order to free the National Radiator Corporation from the obligations to Debentureholders who refused to assent to the Plan of Reorganization." (*39*)

"Nor may he (the debtor) demand that, upon payment of the present liquidation value of his assets, he be released from his debts and that he be permitted to retain those assets free from all future liabilities and obligations." (*44*)

"In the instant case, the Court's power of sale was employed * * * to enable the debtor to retain possession of its property, free from the obligation to its creditors." (*47*)

"Jurisdiction was assumed * * * merely to enable the Corporation, through reorganization, to scale its funded debt." (*47*)

"The Court, through the exercise of its jurisdiction, took the property of the non-assenting Debentureholders and quite gratuitously gave it to the Corporation." (*49*)

"Courts of equity may not by judicial process transfer the property of one corporation to another having the same stockholders." (*49*)

"* * * The appeal was made to the Court to employ its power of sale and distribution as a subterfuge in order to accomplish the transfer, to the National Radiator Corporation, disguised in the form of a new corporation, of all its business, property and assets as a going concern * * *." (*51*)

Petitioners seem to believe that National Radiator Corporation, the insolvent debtor, is to continue in existence unscathed and rejuvenated by the reorganization and that it will commence a new life with its debts commuted and released and its properties freed from the claims of creditors. This, of course, is absolutely contrary to the fact. The fact is, that it is the purpose of the Plan of Reorganization, and it is the necessary effect of this suit and of the decrees already entered, that the old National Radiator Corporation shall, to all intents and purposes,

be absolutely and finally wiped out, and all its property taken from it. Upon the consummation of the Plan of Reorganization, **the whole enterprise will be owned and controlled by the old Corporation's creditors**, except for the minor interest in the equity which is given preferred stockholders. The Corporation will not be permitted to retain any assets. The New Company is not the old National Radiator Corporation "disguised in the form of a new corporation". It is a brand new company with entirely different stockholders, who are the creditors of the old Corporation.

The old Corporation's debts will not be released through the medium of the reorganization or through the decrees entered in this suit. True, all its property has been taken from it for the benefit of its creditors and therefore it is physically incapable of making any further payments on its debts. It is only a shell. However, creditors cannot hope, by any device, to get anything more than all the Corporation's assets.

It is utterly misleading to say that the Corporation is fleeing for refuge from its creditors. On the contrary, it has surrendered all its property unconditionally to a court of equity to be administered equitably for the benefit of all its creditors. At this point, it is fair to observe that nine months elapsed after the Corporation's default in Debenture interest before the Corporation even "fled for refuge from its creditors"; and during that entire period these petitioners were under no restraint whatsoever from asserting the legal rights which they now seek to exercise.

This suit really represents a two years' effort on the part of the great body of creditors to take over the corporate property for themselves. Their efforts have not been

opposed by the Corporation, but strenuous resistance has come from a few creditors. Except for the obstruction by these few creditors, the overwhelming majority of the creditors would long ago have taken over all of the corporate assets; they would have been in control of the management, and they would constitute the New Company. These few creditors are unwilling for some reason to retain their *pro rata* interest in the corporate enterprise by accepting securities of the New Company, even though these new securities would give them more than the same aliquot share in the enterprise which they now possess. These petitioners argue that they would prefer to remain as creditors of the old Corporation, notwithstanding it is utterly insolvent and would necessarily be a bankrupt if this suit were dismissed. Their fellow petitioners in the companion cases at Nos. 62 and 63 at least urge that their debts be enforced through liquidation of the enterprise, but these petitioners do not want the property of this insolvent Corporation to be administered by a court of equity at all. They urge that the property be returned to the Corporation, so that they may have an opportunity, freed from judicial restraint, to prey upon it, through the enforcement of their asserted Constitutional rights to secure judgment at law and to levy execution. No creditor has a vested right to such preferential payment.

Kingsport Press, Inc. v. *Brief English Systems, Inc.* (C. C. A., 2nd Cir., 1931), 54 Fed. (2d) 497.

Respondents submit:

I. This suit was properly brought to enforce the rights of all creditors against the debtor Corporation.

II. The exercise of jurisdiction in this suit by the District Court did not violate the Fifth Amendment of the Constitution of the United States.

ARGUMENT

I.

This suit was properly brought to enforce the rights of all creditors against the debtor Corporation.

It is perfectly clear from the Record, and it was so found by the District Court and the Circuit Court of Appeals, that the defendant Corporation, at the time this suit was instituted, was faced with imminent insolvency; and it is well settled that a creditors' bill in equity is properly brought under these circumstances, even though the defendant debtor is not technically insolvent at the time.

Luhrig Collieries Co. v. *Interstate Coal & Dock Co.* (S. D. N. Y., 1922), 281 Fed. 265;

In re Babcock (C. C. A., 7th Cir., 1928), 26 Fed. (2d) 153;

Brassey v. *N. Y. & New Eng. R. Co.* (D. Conn., 1884), 19 Fed. 663.

Petitioners contend that the imminence of the insolvency was not alleged with sufficient certitude in the bill of complaint. Their version of the allegations of the complaint is that it forecast only a possible insolvency and they say this renders the whole proceeding defective and the two decrees erroneous. However, the fact is that by June 30, 1932 and ever thereafter, the Corporation was in fact utterly insolvent in every sense of the word (R. 523, 524); and we submit that this is the all important circumstance now before this Court and that the District Court should not now be divested of jurisdiction over this suit for some fancied imperfection in the original bill of complaint.

Brown v. *Lake Superior Iron Co.* (1890), 134 U. S. 530.

So far as concerns the charge of collusion made in petitioners' brief, this charge has been made many times and has invariably been disposed of, in the absence of evidence of actual fraud, by an unbroken line of decisions, holding that a consent receivership, merely because it is a consent receivership, is not fraudulently collusive.

In re Metropolitan Railway Receivership (1908), 208 U. S. 90.

All of the cases, such as *Pusey & Jones Co.* v. *Hanssen*, 261 U. S. 491, cited in petitioners'-brief, for the proposition that a court of equity does not have the power to seize the assets of a corporation simply because of its mere refusal to pay its debts, are cases where the debtor opposed the suit and consequently these cases have no bearing on the instant case, because in the instant case the Corporation made no objection, but admitted the allegations of the bill and consented to the appointment of Receivers and the Court therefore had undoubted jurisdiction.

In re Metropolitan Railway Receivership (1908), 208 U. S. 90;

Horn v. *Pere Marquette R. Co.* (E. D. Mich., S. D., 1907), 151 Fed. 626;

Burton v. *R. G. Peters Salt & Lumber Co.* (W. D. Mich., S. D., 1911), 190 Fed. 262;

In re Babcock (C. C. A., 7th Cir., 1928), 26 Fed. (2d) 153;

Kingsport Press, Inc. v. *Brief English Systems, Inc.* (C. C. A., 2nd Cir., 1931), 54 Fed. (2d) 497.

So far as concerns the statement in petitioners' brief that no controversy existed between the Reorganization Committee and National Radiator Corporation, the fact is that the latter owed a debt to the former which had not

been paid, and in the *Metropolitan Railway Receivership* case it was held that this state of facts presented a controversy sufficient to give the court jurisdiction to entertain a creditors' bill and to appoint receivers.

The petitioners' brief concludes with the charge that this cause was instituted for the purpose of effecting a reorganization of the National Radiator Corporation in accordance with the Plan, as though, in this fact alone, there was something heinous. The authorities cited in the petitioners' brief, however, all dealt with attempts to accomplish some inequitable reorganization. But where, as in the instant case, equity jurisdiction has properly been exercised to conserve and sell the assets of a failing enterprise for the benefit of all its creditors, we submit that the existence of a plan of reorganization, outlining what the creditors propose to do with those assets, if they acquire them, has no bearing upon the jurisdictional sufficiency or the propriety of their creditors' bill. It does not seem conceivable that a creditors' bill, which in the ordinary case would meet every test of legal sufficiency, becomes fatally defective simply because prior to its filing the complainants or the overwhelming majority of its creditors have announced that they intend to effect a reorganization and have promulgated a plan. Most equity receiverships of large industrial corporations ultimately result in reorganization, because the creditors have no alternative but to buy in their debtor's assets. Unless they could do so and unless they could plan to do so, most insolvent corporations, once in the hands of the courts, would have to remain there.

The Plan of Reorganization itself was not formulated or promulgated or approved by the debtor Corporation. This suit was not a scheme to coerce non-assenting Deben-

tureholders into the Plan or else to wipe out their rights under the Debentures. All Debentureholders were offered equal treatment and this opportunity is still open to the petitioners. If Debentureholders do not wish to participate in the Plan, they are entitled to receive in cash their fair distributive share of the net proceeds of the sale of their debtor's assets. But it does not follow that they had a right to say that these assets should not be sold. Obviously the assets did not suffice to pay all creditors in full and this suit was a proper and usual method to secure fair treatment to all creditors of the Corporation. In an analogous situation, presented in the case of *Simon* v. *New Orleans, T. & M. R. Co.* (C. C. A., 5th Cir., 1917), 242 Fed. 62, the Court said:

> "Furthermore it is apparent that the organization of the committee is not a combination against the petitioner, for he was invited to join it more than two years ago, and this course is still open to him. If the combination is highly advantageous to those engaging in it, the petitioner may have all of these advantages by complying with the same conditions."

These petitioners do not want reorganization and they say they are being deprived of their rights by this suit which will give them in cash their fair distributive share of the Corporation's properties. These petitioners apparently think that nothing at all should have been done, although all other creditors who have studied the situation (including the petitioners in the companion cases at Nos. 62 and 63, who assert that the Corporation was a "demonstrated failure") are definitely of the opinion that there are only two possible courses: reorganization or liquidation.

The practical result of petitioners' argument is, that creditors would have no equitable redress against their debtor until it has bled itself white in paying all its debts as they mature, notwithstanding the consequences of such a course would be detrimental to the great body of creditors who were unable through actions at law or otherwise to obtain priority of payment. It is true that some corporations, even after they see the handwriting on the wall, in an effort to defer as long as possible the stigma of receivership or bankruptcy will continue to pay maturing obligations as long as they have any cash available for the purpose, even though such a course may eventually prove disastrous to the creditors themselves. The ultimate consequence is that, when the cash is gone and the situation crashes and bankruptcy or receivership ensues, there is no money left to carry on the business and unless new money can be found, which is practically impossible in these times, the property must, of necessity, be liquidated at sacrifice prices. There remains for the greater number of creditors a residue of frozen assets. It frequently happens that there is not enough left to pay taxes, prior liens and the costs and expenses of liquidation in bankruptcy. Everyone loses.

II.

The exercise of jurisdiction in this suit by the District Court did not violate the Fifth Amendment of the Constitution of the United States.

We have argued that jurisdiction of this suit was properly entertained by the District Court under established usages and principles of equity, and that neither this suit

nor the Plan of Reorganization will deprive the petitioners of any of their vested rights in any property of the Corporation. Judicial proceedings which accord with those rules and principles which have been established in our system of jurisprudence for the protection and enforcement of private rights are due process of law.

Pennoyer v. *Neff* (1887), 95 U. S. 714.

As stated in the opinion of this Court in *Shapiro* v. *Wilgus* (1932), 287 U. S. 348, when a creditor invokes the aid of equity to conserve a common fund for the benefit of himself and of the creditors at large, "*whatever hindrance and delay of suitors is involved in such a remedy may then be incidental and subsidiary*".

CONCLUSION

The decrees of the courts below should be affirmed.

Respectfully submitted,

LAWRENCE BENNETT,
MAYNARD TEALL,
G. FRANKLIN LUDINGTON,
Counsel for Respondents Rudolph B. Flershem, Charles O. Cornell, John H. Waters and Frank B. Cahn, as the Reorganization Committee constituted under the Plan and Agreement dated February 11, 1931, for the Reorganization of National Radiator Corporation.

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